

### § 1.542-3

### 26 CFR Ch. I (4-1-03 Edition)

corporation for the taxable year be personal holding company income as defined in section 543 and §§1.543-1 and 1.543-2. For the definition of *gross income* see section 61 and §§1.61-1 through 1.61-14. Under such provisions gross income is not necessarily synonymous with gross receipts. Further, in the case of transactions in stocks and securities and in commodities transactions, gross income for personal holding company tax purposes shall include only the excess of gains over losses from such transactions. See section 543(b), paragraph (b) (5) and (6) of §1.543-1 and §1.543-2. For determining the character of the amount includible in gross income under section 951(a), see paragraph (a) of §1.951-1.

[T.D. 6500, 25 FR 11737, Nov. 26, 1960, as amended by T.D. 6795, 30 FR 934, Jan. 29, 1965]

#### § 1.542-3 Stock ownership requirement.

(a) *General rule.* To meet the stock ownership requirement, it is necessary that at some time during the last half of the taxable year more than 50 percent in value of the outstanding stock of the corporation be owned, directly or indirectly, by or for not more than 5 individuals. Any organization or trust to which subparagraph (1) of this paragraph applies shall be considered as one individual for purposes of this stock ownership requirement subject, however, to the exception in subparagraph (2) of this paragraph which is applicable only to taxable years beginning after December 31, 1954. Thus, if an organization or trust which is considered as an individual owns 51 percent in value of the outstanding stock of the corporation at any time during the last half of the taxable year, the stock ownership requirement will be met by ownership of the required percentage by one individual. See section 544 and §§1.544-1 through 1.544-7 for the determination of stock ownership.

(1) *An organization or trust considered as an individual.* Any of the following organizations or trusts shall be considered as an individual:

(i) An organization to which section 503 applies, namely, any organization described in section 501(c)(3) (relating to charitable, etc., organizations) or section 401(a) (relating to employees'

pension trust, etc.) other than an organization excepted from the application of section 503 by paragraphs (1) to (5) of section 503(b). Therefore, a religious organization (other than a trust) excepted under section 503(b)(1) is not considered an individual for purposes of the stock ownership requirement of section 542(a)(2).

(ii) A portion of a trust permanently set aside or to be used exclusively for the purposes described in section 642(c), relating to amounts set aside for charitable purposes, or described in a corresponding provision of the prior income tax law (such as section 162(a), Internal Revenue Code of 1939).

(2) *Exception.* For taxable years beginning after December 31, 1954, an organization or trust to which subparagraph (1) of this paragraph applies shall not be considered an individual if all of the following conditions are met:

(i) It was organized or created before July 1, 1950.

(ii) At all times on or after July 1, 1950, and before the close of the taxable year, it owned all of the common stock and at least 80 percent of the total number of shares of all other classes of stock of the corporation.

(iii) For the taxable year it is not denied exemption under section 504(a) or the unlimited charitable deduction under section 681(c). In determining whether, for the purpose of section 542(a)(2), exemption is not denied under section 504(a) or the unlimited charitable deduction is not denied under section 681(c) all the income of the corporation which is available for distribution as dividends to its shareholders shall be deemed to have been distributed at the close of the taxable year whether or not any portion of such income was in fact distributed. If the amounts described in section 504(a) or section 681(c), increased by the income of the corporation deemed distributed pursuant to the preceding sentence, would be sufficient to deny exemption or the unlimited charitable deduction, the organization or trust will be considered to be an individual for the purpose of section 542(a)(2). For the purpose of this subdivision the restrictions in sections 504(a)(1) and

681(c)(1) against unreasonable accumulations will not apply to income attributable to property of a decedent dying before January 1, 1951, which was transferred during his lifetime to a trust or property that was transferred under his will to such trust, and

(iv) This subparagraph is illustrated by the following example:

*Example.* The X Charitable Foundation (an organization described in section 501(c)(3) to which section 503 is applicable) has owned all of the stock of the Y Corporation since Y's organization in 1949. Both X and Y are calendar-year corporations. At the end of the year 1955, X has accumulated \$100,000 out of income and has actually paid out only \$75,000 of this amount, leaving a balance of \$25,000 on December 31, 1955. X was not denied an exemption under section 504(a) for the year 1955. Y, during the calendar year 1955, has \$400,000 taxable income of which \$200,000 is available for distribution as dividends at the end of the year. X will be considered to have accumulated out of income during the calendar year 1955 the amount of \$225,000 for the purpose of determining whether it would have been denied an exemption under section 504(a)(1). If X would have been denied an exemption under section 504(a)(1) by reason of having been deemed to have accumulated \$225,000, the stock ownership requirement of section 542(a)(2) and this section will have been satisfied. If Y Corporation also satisfies the gross income requirement of section 542(a)(1) and § 1.542-2 it will be a personal holding company.

(b) *Changes in stock outstanding.* It is necessary to consider any change in the stock outstanding during the last half of the taxable year, whether in the number of shares or classes of stock, or in the ownership thereof. Stock subscribed and paid for will be considered as stock outstanding, whether or not such stock is evidenced by issued certificates. Treasury stock shall not be considered as stock outstanding.

(c) *Value of stock outstanding.* The value of the stock outstanding shall be determined in the light of all the circumstances. The value may be determined upon the basis of the company's net worth, earning and dividend paying capacity, appreciation of assets, together with such other factors as have a bearing upon the value of the stock. If the value of the stock is greatly at variance with that reflected by the corporate books, the evidence of such value should be filed with the return.

In any case where there are two or more classes of stock outstanding, the total value of all the stock should be allocated among the different classes according to the relative value of each class.

[T.D. 6500, 25 FR 11737, Nov. 26, 1960, as amended by T.D. 6739, 29 FR 7713, June 17, 1964]

#### § 1.542-4 Corporations filing consolidated returns.

(a) *General rule.* A consolidated return under section 1501 shall determine the application of the personal holding company tax to the group and to any member thereof on the basis of the consolidated gross income and consolidated personal holding company income of the group, as determined under the regulations prescribed pursuant to section 1502 (relating to consolidated returns); however, this rule shall not apply to either (1) an ineligible affiliated group as defined in section 542(b)(2) and paragraph (b) of this section, or (2) an affiliated group of corporations a member of which is excluded from the definition of a personal holding company under section 542(c) and paragraph (c) of this section. Thus, in the latter two instances the gross income requirement provided in section 542(a)(1) and § 1.542-2 shall apply to each individual member of the affiliated group of corporations.

(b) *Ineligible affiliated group.* (1) Except for certain affiliated railroad corporations, as provided in subparagraph (2) of this paragraph, an affiliated group of corporations is an ineligible affiliated group and therefore may not use its consolidated gross income and consolidated personal holding company income to determine the liability of the group or any member thereof for personal holding company tax (as provided in paragraph (a) of this section), if (i) any member of such group, including the common parent, derived gross income from sources outside the affiliated group for the taxable year in an amount equal to 10 percent or more of its gross income from all sources for that year and (ii) 80 percent or more of the gross income from sources outside the affiliated group consists of personal holding company income as defined in section 543 and §§ 1.543-1 and 1.543-2.